

How Countries Differ:

National Differences in Political, Economic, and Legal Systems

Chapter 2

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How countries differ and what it means for international business?

Chapter 2

- Political economy
 - Political system
 - Economic system
 - Legal system

Chapter 4

- Culture

Political Economy

- A term signifying the **political**, **economic**, and **legal** systems of a country; they interact and influence each other, and, in doing so, they affect the level of economic well-being
- The political economy of a nation has important implications for both domestic and foreign companies in that nation

POLITICAL SYSTEM

- The system of government in a nation
- Political systems can be assessed according to two broad dimensions
 - The degree to which they emphasize **collectivism** versus **individualism**
 - The degree to which they are **democratic** or **totalitarian**

Collectivism and Individualism

Collectivism

- Collective goals (societal needs) are more important than individual goals
- Individual rights may be restricted for the “good of society”
- In the modern world collectivism has been expressed through **socialism**

Individualism

- Individual goals are more important than collective goals (i.e., the society’s goals)
- Individual economic and political freedoms are the ground rules on which society is based
- Individuals have the freedom to pursue their own economic and political goals
 - The role of the **invisible hand**

Socialism

Karl Marx (1818-1883): In a capitalist society where individual freedoms are not restricted, the few benefit at the expense of the many... This can be corrected by state ownership of the means of production, distribution, and exchange (i.e., businesses)

Communism

- A belief that socialism can only be achieved through violent revolution and a totalitarian regime
- Had its high point in the 1970s
- All means of production and exchange are owned by the state

Social Democracy

- A belief that socialism can be achieved through democratic means
- Emergence of **state owned enterprises** (SOEs) through **nationalization**

Socialism: Recent Experiences

- State ownership of means of production does not further public interest
- Poor performance of the SOEs
 - Fall of social democratic political governments, late 1970s and early 1980s
 - Fall of the Soviet Union, 1989
 - Formerly socialistic states began moving toward individualism, democracy, and market economies
 - Privatization and liberalization

Democracy and Totalitarianism

Democracy

- Government is by the people, exercised either directly or through elected representatives (**representative democracy**)
- Elected representatives are held accountable through constitutional safeguards (**constitutional guarantees**)

Totalitarianism

- One person or party exercises absolute control over all spheres of human life
- Other political parties are not allowed
- Constitutional guarantees are typically denied to citizens
- Political repression

Typical Safeguards in a Representative Democracy

1. Freedom of expression, opinion and organization
2. Free media
3. Regular elections
4. Universal adult suffrage
5. Limited terms for elected representatives
6. A fair court system that is independent from the political system
7. A non-political state bureaucracy
8. A non-political police force and armed services
9. Relatively free access to state information

Totalitarianism

Four kinds of totalitarianism:

- Communist totalitarianism
- Theocratic totalitarianism
- Tribal totalitarianism
- Right wing totalitarianism
 - Typically allows some economic freedom, but not political freedom to the citizens
 - Often backed by military, or the government is run by military officers

ECONOMIC SYSTEMS

- Types of economic systems
 - Market economy
 - Command economy
 - Mixed economy
- There is a connection between political ideology and economic systems
 - In countries where individual goals are given primacy, free market economic systems are fostered
 - In countries where collective goals are given primacy, there is typically state control of markets

Market Economy

- In a *pure* **market economy**, what is produced and in what quantity are determined by **market forces** and signaled to producers through the **price system**
- All productive activities are privately owned
- For a market to work in this manner:
 - Supply must not be restricted
 - The role of the government is to encourage vigorous and free competition among private producers/sellers
 - Private owners (entrepreneurs) have the right to the profits generated by their own efforts

→ **Efficiency, innovation, economic growth**

Command Economy and Mixed Economy

- In a *pure* **command economy**, all decisions regarding what is to be produced, in what quantity, and the prices to be charged are planned by the government
 - The government's objective is to allocate resources for "the good of the society"
 - All businesses are state owned
- In a **mixed economy**, some sectors of the economy are state owned and some are under private control
 - The government typically takes control of firms/industries that are considered to be of national importance

→ Recent experiences

LEGAL SYSTEMS

- A “legal system” is a set of rules and laws that regulate behavior
 - The processes through which laws are enforced and grievances are redressed
 - The manner in which transactions are to be executed
 - Specifies the rights and obligations of parties to business transactions
- Three main types of legal systems in the world:
 - Common law
 - Civil law
 - Theocratic law

Common Law

- Evolved in England over hundreds of years
 - Still used in former colonies
- Based on:
 - **Tradition** - a country's legal history
 - **Precedent** - how past cases were decided
 - **Custom** - how laws are applied in specific situations
- Judges have the power to interpret the law so that it applies to the unique circumstances of an individual case
 - Each interpretation sets a precedent that may be followed in the future
 - This can lead to changes in the country's laws to deal with new situations

Civil Law

- Based on a very detailed set of laws organized into codes
- Courts interpret civil law based on the codes
- More than 80 countries operate with a civil law system, including Germany, France, Japan, and Russia
- Judges have less flexibility than those in a common law system
- A civil law system can be less adversarial than the common law system

Theocratic Law

- Based upon religious teachings
- **Islamic law** is the most widely practiced theocratic legal system in the modern world, although both Hindu and Jewish law have persisted into the 20th century
- Islamic law is based on moral behavior
 - Foundation – the Koran and the sayings of Prophet Mohammed
 - Has been extended to cover commercial transactions

CONTRACT LAW

- **Contract** – a document that specifies the conditions under which an exchange is to occur and details the rights and obligations of the parties involved
- **Contract law** is the body of law that governs the enforcement of contracts
 - Under a common law system, contracts tend to be very detailed with all contingencies spelled out, and resolving a contract dispute can be quite adversarial
 - However, judges have more flexibility in dealing with disputes
 - Under a civil law system, contracts tend to be much shorter and less specific because many issues are already covered in the civil code

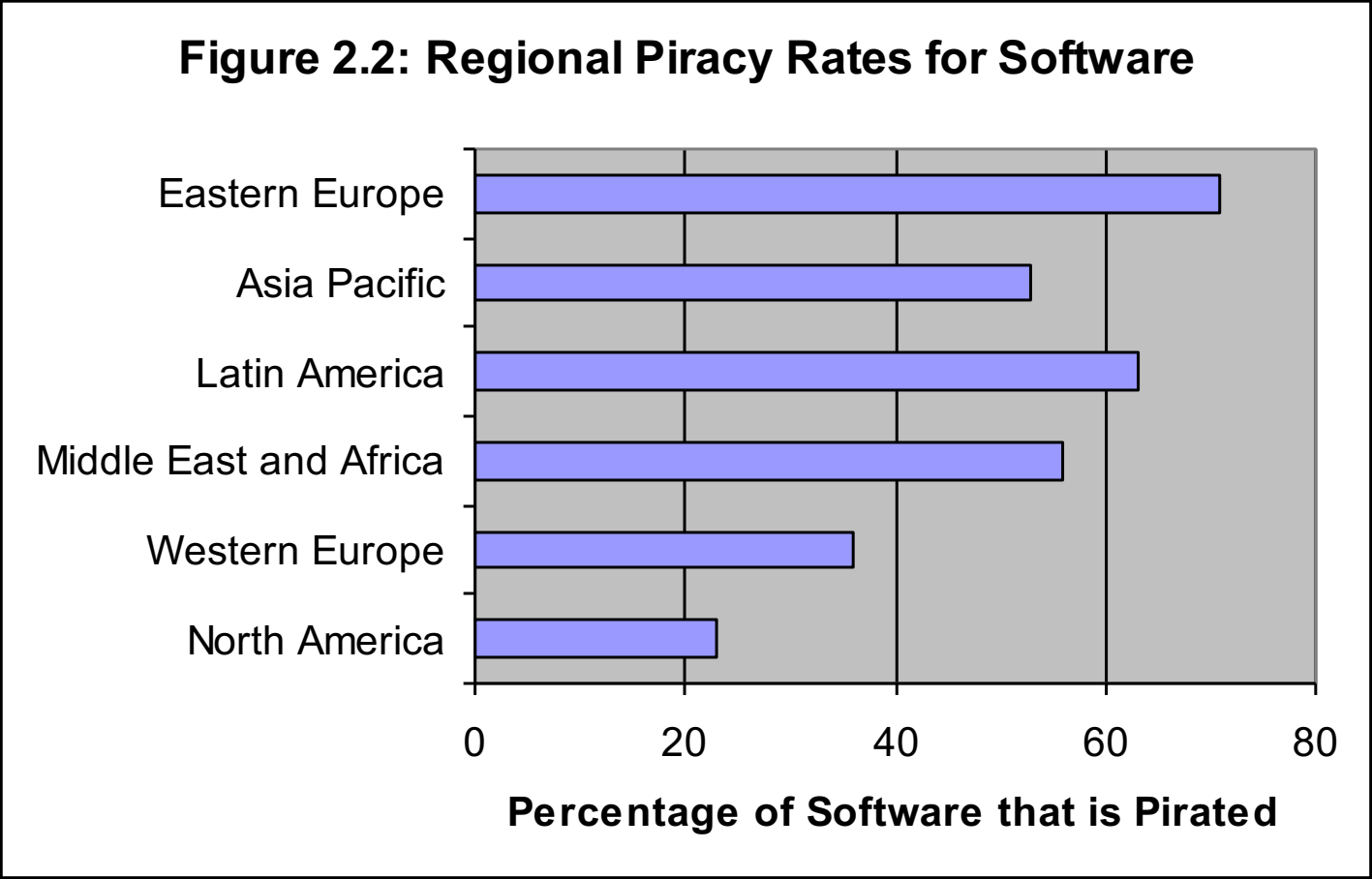
PROPERTY RIGHTS

- **Property:** A resource over which an individual or a business has legal title
 - **Property Rights:** A bundle of legal rights over the use to which a resource is put and over the income derived from that resource
 - Can be violated through
 - Private action
 - Public action (“legal”) and corruption
- Implications of high level of corruption in a country

Intellectual Property Rights

- **Intellectual property** refers to property that is the product of intellectual activity → patents, copyrights, and trademarks
- How intellectual property is protected:
 - **Patents** – exclusive rights for a defined period for the manufacture, use, or sale of inventions
 - **Copyrights** – the exclusive legal rights of authors, composers, playwrights, artists, and publishers to publish and disperse their work as they see fit
 - **Trademarks** – designs and names by which merchants or manufacturers designate and differentiate their products

Piracy of Intellectual Property



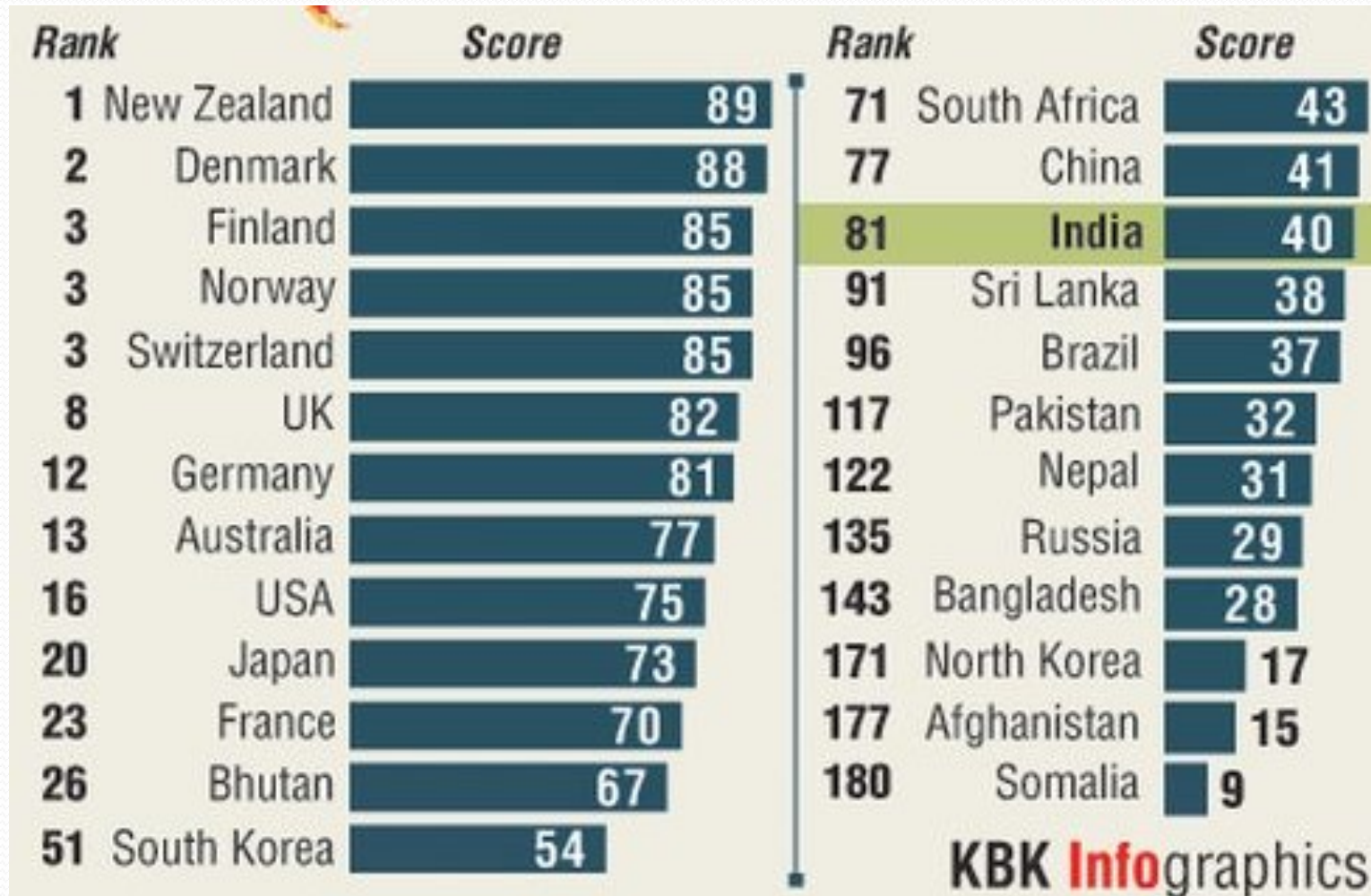
Laws to Protect Intellectual Property Rights

- **Intellectual property laws** are a very important stimulus to innovation and creative work
 - Provide incentive to search for novel ways of doing things
- Protection of intellectual property rights differs greatly from country to country; it's a big issue in international business
- **TRIPS**: Trade Related Intellectual Property Rights
 - WTO members are obliged to grant and enforce patents of WTO members for at least 20 years and copyrights for 50 years

CORRUPTION

- Corruption is a form of dishonest or unethical conduct by a person entrusted with a position of authority, often to acquire personal benefit
- It may include many activities including bribery and embezzlement, though it may also involve practices that are legal in many countries
- **Corruption Perception Index**: A country or territory's score indicates the perceived level of public sector **corruption** on a scale of 0 (highly **corrupt**) to 100 (very clean), relative to other countries and territories included in the **index**; the 2018 **index** includes 180 countries and territories

Corruption Perceptions Index, 2017



Source:

<https://www.transparency.org/>

Foreign Corrupt Practices Act, 1977 (USA)

- Enacted in 1977 as an “anti-bribery” law
- Applies to activities outside US or for “interstate commerce”
 - Cannot give or offer to give “anything of value”, even indirectly
 - to a foreign official, a candidate for office or a political part
 - for “corrupt purpose” of causing a person to act or not act or to otherwise secure an improper advantage
 - to obtain or retain business or direct it to particular persons
- Has both accounting and anti-bribery provisions
 - Accounting rules designed to identify bribery, concealment, and mischaracterization
- Single statutory exception -- “routine governmental actions”

PRODUCT SAFETY AND LIABILITY LAWS

- **Product safety laws** set safety standards for products and manufacturing processes
 - Recent cases: Takata air bags, Chinese toys, and others
 - **Product liability laws** hold firms and their officers responsible when a product causes injury, damage, or death
 - **Civil law/criminal laws**
 - Civil law calls for payment of monetary damages
 - Criminal liability laws result in fines and/or imprisonment
- **Competitiveness issues**
- **Ethical issues**